Tennessee Local Development Authority

For the Year Ended
June 30, 2003

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

February 17, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee Local Development Authority
State Capitol
Nashville, TN 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Local Development Authority for the year ended June 30, 2003. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/eb
04/019

State of Tennessee

A u d i t   H i g h l i g h t s

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee Local Development Authority
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

The objectives of the audit were to consider the Authority's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts (including bond resolutions); to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee Local Development Authority
For the Year Ended June 30, 2003

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Tennessee Local Development Authority
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Local Development Authority. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated,* which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee Local Development Authority was created April 2, 1978, by an act of the General Assembly, codified as Title 4, Chapter 31, *Tennessee Code Annotated.* The Authority is delegated the responsibility for issuing its debt obligations to provide funds to make loans to local governments for the State Loan Program and for capital projects; certain small business concerns for pollution control facilities; farmers for certain capital improvements; counties for the acquisition of equipment for use by county or volunteer fire departments serving unincorporated areas of the counties; airport authorities and municipal airports; and mental health/retardation/alcohol and drug facilities (the Community Provider Pooled Loan Program). To date, the Authority has issued debt only to fund the State Loan Program and the Community Provider Pooled Loan Program.

ORGANIZATION

The Tennessee Local Development Authority is composed of the Governor, the Secretary of State, the Comptroller of the Treasury, the State Treasurer, the Commissioner of Finance and Administration, and two other members—one appointed by the Speaker of the Senate from nominations by the Tennessee County Services Association and the other by the Speaker of the House from Nominations by the Tennessee Municipal League. The Governor serves as Chairman, and the Comptroller of the Treasury serves as Secretary.

An organization chart for the Tennessee Local Development Authority is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The Tennessee Local Development Authority has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the Authority's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, and contracts (including bond resolutions);

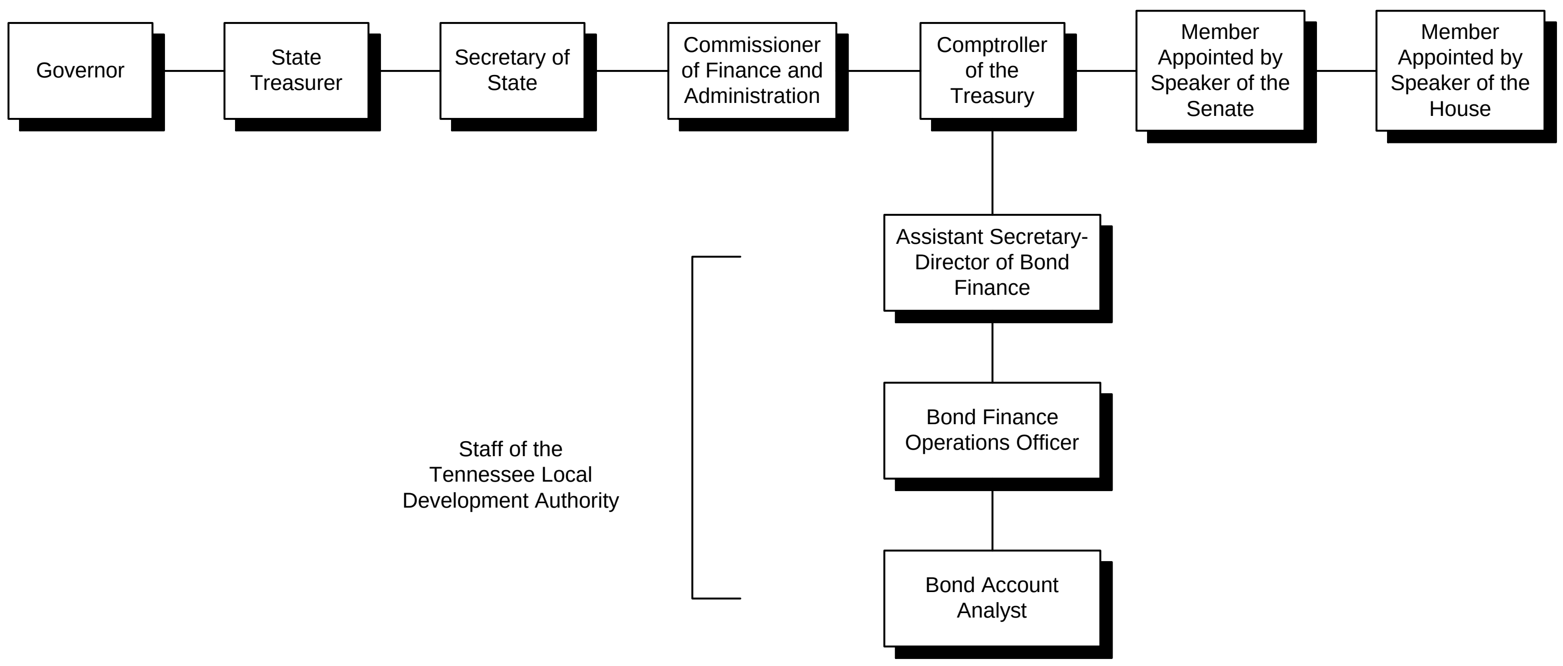
3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
ORGANIZATION CHART



RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee Local Development Authority's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee Local Development Authority's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

November 21, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 21, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of the Authority's compliance with certain provisions of laws, regulations, and contracts (including the bond resolutions), noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/eb

STATE OF TENNESSEE
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Independent Auditor's Report

November 21, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Tennessee Local Development Authority, a component unit of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2003, and June 30, 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan
November 21, 2003
Page Two

The management's discussion and analysis section is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements, taken as a whole. The accompanying financial information on pages 25 through 27 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 21, 2003, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts (including bond resolutions). That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/eb

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Tennessee Local Development Authority, we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal years ended June 30, 2003, and June 30, 2002.

Program Activity Highlights

The Authority's purpose is to provide loans to Local Government Units under the State Loan Programs, and to qualified borrowers under the Community Provider Loan program. The table below summarizes this business activity.

	Local Government Units			Community Providers		
	2003	2002	2001	2003	2002	2001
Number of borrowers with outstanding loans	49	60	60	15	18	19
Total number of outstanding loans	91	114	115	20	24	26
Total amount of outstanding loans (in thousands)	$76,067	$82,685	$83,118	$7,987	$12,360	$13,236
Number of loans approved in fiscal year	0	2	0	0	0	0
Amount of loans funded in fiscal year (in thousands)	0	$11,810	0	0	0	0

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity. For more specific financial information on long-term debt activity, see Note 5, Debt Payable, in the Notes to the Financial Statements.

Debt Administration

Pursuant to Title 4, Chapter 31, *Tennessee Code Annotated*, the General Assembly of the state created the Tennessee Local Development Authority to issue bonds and notes to fund capital projects for a variety of purposes. Currently, the active programs of the Authority include:

> (1) the State Loan Programs providing assistance to Local Government Units in the construction of waterworks, sewage treatment, and energy and/or solid waste recovery facilities; and
>
> (2) the Community Provider Program providing facility construction assistance to licensed, nonprofit, 501(c)(3) corporations under grant contracts with the state to deliver mental health, mental retardation, or alcohol and drug services.

A financial analysis of each loan in the State Loan Programs is undertaken before it is approved by the Authority. Each Local Government Unit must demonstrate that it has enacted rates and fees sufficient to repay the debt, including operations, maintenance, and depreciation. The Authority is authorized to intercept the local community's state-shared taxes, should the government unit fail to repay timely its loan. Similarly, Community Providers must also charge fees sufficient to repay their debt, including operations, maintenance, and depreciation. The Authority is also authorized by statute to intercept the state appropriation to the Community Provider should the borrower fail to make timely debt service payments to the Authority.

Under the financing program for the State Loan Programs, during the construction phase of a project, the project generally is funded through the issuance of Bond Anticipation Notes. When sufficient projects are completed to assure an appropriate economy of scale, the Authority fixes the interest rate for the term of the project by issuing long-term debt. Interest rates on the State Loan Programs facilities long-term fixed-rate loans range from a low of 1.95% to a high of 7.25%. By pooling the financing of their capital needs, management believes that economic efficiencies of a single large borrowing administered by one agency are achieved. The creditworthiness of both large and small Local Government Units is homogenized into one credit resulting in a lower cost of borrowing to all participants.

The Authority's State Loan Programs is rated A+, A1, and AA by Fitch, Moody's Investors Service, and Standard & Poor's Rating Group, respectively. Fitch comments that the rating reflects the quality administration of the program and successful market access for 20 years. Standard & Poor's cites the underlying credit quality of the local governments receiving loans. Moody's comments that the responsibility of the localities to repay loans, the sound legal provisions, and state oversight were factors in the rating process.

The Community Provider program was originally authorized in 1990 by the legislature to provide construction financing for eligible borrowers at interest rates lower than would otherwise be obtainable from private industry. The program was initially funded through the issuance of the 1992 and the 1994 Community Provider bonds. In 1999, the State Funding Board loaned $16,000,000 to the Authority to defease the 1992 and 1994 bonds. The interest rate on the loan varies according to market conditions for the State of Tennessee's general obligation commercial paper. The rate ranged from 1.26% to 1.87% during 2003, and from 1.83% to 3.76% during 2002.

Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses enterprise fund accounting. The financial statements are prepared in conformity with accounting principles generally accepted in the United States of America using the accrual basis of accounting and the flow of economic resources measurement focus. This basis recognizes revenues when earned and expenses at the time liabilities are incurred. Using the economic resources measurement focus, a reader is presented information that allows him to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise two components: (1) the basic financial statements and (2) notes to the financial statements. The basic financial statements consist of the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. The Statement of Net Assets depicts the Authority's financial position at June 30, 2003. The Statement of Revenues, Expenses, and Changes in Net Assets reports the results of inflows and outflows and the change in net assets for the year. The Statement of Cash Flows summarizes the sources and uses of cash throughout the fiscal year. These statements are supplemented by notes to the financial statements that provide information that is essential to the reader's understanding of the financial statements. This report also contains supplementary information containing financial statement information at the program level in addition to the basic financial statements and notes.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goal of the Authority is to provide timely access to the capital markets at the lowest possible cost and to make creditworthy loans. The Authority successfully achieved this goal. There were no incidents requiring the Authority to draw from the debt service reserve fund or refuse a loan from an applicant due to the inability to obtain capital funding.

Statements of Net Assets Summary
(in thousands)

	2003	2002	2001
Current assets	$ 27,422	$ 33,040	$ 29,807
Restricted assets	5,917	6,634	6,958
Other assets	80,478	90,313	91,792
Total assets	113,817	129,987	128,557
Current liabilities	53,648	57,397	51,205
Noncurrent liabilities	48,590	58,739	64,334
Total liabilities	102,238	116,136	115,539
Net assets:			
Restricted net assets	351	351	661
Unrestricted net assets	11,228	13,500	12,357
Total net assets	$ 11,579	$ 13,851	$ 13,018

Note: The Authority owns no capital assets.

During the year ended June 30, 2003, the Authority issued $8,295,000 in State Loan Programs Revenue Refunding Bonds to refund $8,381,000 of outstanding debt. As a part of the refunding, the Authority allowed eligible borrowers to repay all or a portion of their outstanding loan balances. Eleven borrowers participated in this option and redeemed $2,714,000. Long-term principal, including the refunding and the extraordinary redemption, was repaid in the amount of $15,320,000. The Authority also issued $48,500,000 in State Loan Programs Bond Anticipation Notes during the fiscal year. It redeemed $51,000,000 of prior Bond Anticipation Notes, thus reducing short-term debt by $2,500,000. The Community Provider program repaid $4,000,000 of its loan to the State Funding Board with payments made by borrowers.

During the year ended June 30, 2002, long-term principal matured and was repaid in the amount of $4,025,000. The Authority issued $51,000,000 in State Loan Programs Bond Anticipation Notes. It also redeemed $44,500,000 of 2001 Bond Anticipation Notes. The Community Provider program repaid $1,500,000 of its loan to the State Funding Board with payments made by borrowers.

Current assets include cash of $9,352,218 at June 30, 2003, and $11,138,544 at June 30, 2002, representing unexpended note proceeds available to fund loans to State Loan Programs' eligible borrowers. Restricted assets represent the debt service reserve fund. The largest component of both current and noncurrent assets is the loans receivable balance which represents the principal due from borrowers to the Authority. The Authority's unrestricted net assets are available to fund operations and other expenses necessary to meet the goals of the Authority.

Statements of Revenues, Expenses, and Changes in Net Assets Summary
(in thousands)

	2003	2002	2001
Operating Revenues			
Revenue from loans	$ 4,626	$ 5,321	$ 5,948
Investment earnings	857	870	1,735
Total operating revenue	5,483	6,191	7,683
Operating Expenses			
Interest expense	3,833	4,563	5,755
Subsidy to borrowers	453	655	856
Other expenses	494	165	208
Total operating expenses	4,780	5,383	6,819
Operating Income	703	808	864
Nonoperating Revenue (Expense)	(2,975)	25	25
Increase (Decrease) in Net Assets	$ (2,272)	$ 833	$ 889

The Authority's operating expenses are supported by revenue received from the borrowers as a one-time 2% cost of issuance fee at the time of permanent financing, interest on loans, and income on investments. Operating expenses include interest expense on outstanding debt, administrative expenses, and the amortization of bond costs of issuance. The Authority returns a portion of the investment earnings as a subsidy to its borrowers in the State Loan Programs.

For the fiscal year ended June 30, 2003, the decrease in the operating income was most affected by the significant expenses of the refunding issue described above. The Authority chose to pay costs normally borne by the borrowers by using funds available. The average interest rate on investments remained low. In addition, the legislature, in a one-time action, reverted $3 million from the statutory reserve fund to the state's general fund.

For the fiscal year ended June 30, 2002, the decrease in the operating income and change in net assets was most affected by a decrease in investment earnings. The investment earnings are a function of prevailing market interest rates and the daily invested balance. During that year, the capital markets were affected by a declining economy and the economic effect of the terrorist actions. As a result, the average interest rate on investments was significantly lower in fiscal year 2002 than in fiscal year 2001.

Contacting the Authority's Financial Management Team

This discussion and analysis is designed to provide our citizens, Local Government Units, Community Providers, investors, and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Director of Bond Finance, State of Tennessee, Suite 1600, James K. Polk Building, Nashville, Tennessee 37243-0273, or visit our website at www.comptroller.state.tn.us/cpdivbf.htm.

Exhibit A

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003	June 30, 2002
ASSETS		
Current assets:		
Cash (Note 2)	$ 22,739	$ 27,483
Receivables:		
Loans receivable	3,992	5,056
Interest receivable on loans	19	20
Investments (Note 2)	452	299
Interest receivable on investments	220	182
Total current assets	27,422	33,040
Noncurrent assets:		
Restricted assets (Notes 2 and 3)		
Investments	5,917	6,634
Loans receivable	80,062	89,989
Deferred charges	416	324
Total noncurrent assets	86,395	96,947
Total assets	113,817	129,987
LIABILITIES		
Current liabilities:		
Accrued interest payable	927	1,040
Payable to borrowers (Note 4)	416	619
Notes payable (Note 5)	48,950	51,513
Revenue bonds payable (Note 5)	3,355	4,225
Total current liabilities	53,648	57,397
Noncurrent liabilities:		
Loan from the State of Tennessee (Note 5)	8,300	12,300
Revenue bonds payable, net (Note 5)	40,290	46,439
Total noncurrent liabilities	48,590	58,739
Total liabilities	102,238	116,136
NET ASSETS		
Restricted	351	351
Unrestricted	11,228	13,500
Total net assets	$ 11,579	$ 13,851

The Notes to the Financial Statements are an integral part of this statement.

Exhibit B

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003	June 30, 2002
OPERATING REVENUES		
Revenue from loans	$ 4,626	$ 5,321
Interest income	1,053	985
Net (decrease) in fair value of investments	(196)	(115)
Total operating revenues	5,483	6,191
OPERATING EXPENSES		
Interest expense	3,833	4,563
Subsidy to borrowers	453	655
Bond issuance cost	28	25
Arbitrage expense	162	-
Loss on extinguishment of debt	84	-
Administrative expense	220	140
Total operating expenses	4,780	5,383
Operating income	703	808
NONOPERATING REVENUE		
Payment from the State of Tennessee	25	25
Payment to the State of Tennessee	(3,000)	-
Total nonoperating revenue (expense)	(2,975)	25
Change in net assets	(2,272)	833
Net assets, July 1	13,851	13,018
Net assets, June 30	$ 11,579	$ 13,851

The Notes to the Financial Statements are an integral part of this statement.

Exhibit C

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003	June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Payments to federal government	$ (162)	$ -
Payments to service providers	(220)	(140)
Net cash used by operating activities	(382)	(140)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from the sale of bonds	8,353	-
Proceeds from the sale of notes	48,978	51,541
Principal payments	(70,320)	(50,025)
Interest paid	(4,354)	(5,209)
Subsidy to borrowers	(544)	(891)
Payment from the State of Tennessee	25	25
Payment to the State of Tennessee	(3,000)	-
Net cash used by noncapital financing activities	(20,862)	(4,559)
CASH FLOWS FROM INVESTING ACTIVITIES		
Loans issued	(7,936)	(8,976)
Collections of loan principal	19,130	10,251
Interest received on loans	4,312	5,311
Purchase of investments	(5,333)	-
Proceeds from maturity of investments	5,725	-
Interest received on investments	992	985
Bond issuance costs paid	(203)	-
Premium paid	(187)	-
Net cash provided by investing activities	16,500	7,571
Net increase (decrease) in cash	(4,744)	2,872
Cash, July 1	27,483	24,611
Cash, June 30	$ 22,739	$ 27,483
Reconciliation of operating income to net cash used by operating activities:		
Operating income	$ 703	$ 808
Adjustments to reconcile operating income to net cash used by operating activities:		
Amortization	28	25
Revenue from loans	(4,626)	(5,321)
Investment income	(857)	(870)
Interest expense	3,833	4,563
Loss on extinguishment of debt	84	-
Subsidy to borrowers	453	655
Total adjustments	(1,085)	(948)
Net cash used by operating activities	$ (382)	$ (140)
Noncash investing activities:		
(Decrease) in fair value of investments	$ (196)	$ (115)

The Notes to the Financial Statements are an integral part of this statement.

Tennessee Local Development Authority
Notes to the Financial Statements
June 30, 2003, and June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee Local Development Authority was created to provide financial assistance to local governments through the issuance of revenue bonds or notes. The Authority has also issued bonds to assist nonprofit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities. In accordance with the Governmental Accounting Standards Board's Statement No. 14, *The Reporting Entity*, the Authority is reported as a discretely presented component unit in the *Tennessee Comprehensive Annual Financial Report*. Although the Authority is a separate legal entity, its board consists primarily of state officials, and therefore, the state has the ability to affect the day-to-day operations of the Authority.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Tennessee Local Development Authority follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

Effective July 1, 2001, the Authority adopted GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* To conform to the requirements of GASB 34, the following changes have been made to the Authority's financial statements:

A. Retained Earnings have been reclassified into the following categories of Net Assets: invested in capital assets, net of related debt; restricted; and unrestricted. (The Authority has no net assets invested in capital assets.)

B. The statement of financial position is now presented in a statement of net assets format rather than a balance sheet format.

C. Management's Discussion and Analysis has been added as required supplementary information.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

The Tennessee Local Development Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The Authority's principal operation is to provide loans to local governments through the issuance of revenue bonds or notes. Therefore, the principal operating revenues of the Authority are from interest on loans made to borrowers. The Authority also recognizes income on investments as operating revenue. The Authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Cash

This classification includes cash on hand and deposits in the pooled investment fund administered by the State Treasurer.

Investments

Investments are stated at fair value.

Bond Discounts and Issuance Costs

Bond discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable unamortized bond discount. Unamortized issuance costs are reported as deferred charges.

NOTE 2. DEPOSITS AND INVESTMENTS

Deposits. Under the general bond resolution of the Tennessee Local Development Authority, the funds of the Authority are to be deposited with the State Treasurer and can be invested in any security deemed acceptable to Treasury standards.

The Authority had $22,738,607 in the State Treasurer's pooled investment fund at June 30, 2003, and $27,482,621 at June 30, 2002. The pooled investment fund is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies which are fully guaranteed as to principal and interest by the United States; and in certain obligations of the State of Tennessee pursuant to Section 9-4-602(b), *Tennessee Code Annotated*. The pooled investment fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report*. The report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

Investments. Investments are required to be categorized to indicate the level of custodial risk assumed by the Authority. All of the Authority's investments are category 1, which consists of investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name.

Authority investments at June 30, 2003, and June 30, 2002, are categorized below (expressed in thousands):

	Category 1	
	June 30, 2003	June 30, 2002
U.S. Treasury Notes	$5,170	$5,734
U.S. Treasury Securities-State and Local Government Series	1,199	1,199
Total investments	$6,369	$6,933

NOTE 3. RESTRICTED ASSETS

The general bond resolution of the Authority requires that the principal of each bond issue include an amount equal to one year's debt service requirement and that such amount be placed in special trust accounts with the trustee. The required debt service reserve is $5,890,872 at June 30, 2003, and $6,634,355 at June 30, 2002.

The general bond resolution also requires that the debt service requirement in any year of the refunding bonds must not exceed the debt service requirement in any year of the refunded bonds. Two of the largest borrowers in the 2003 refunding issue chose to shorten the term of their loans by one year, causing the new debt service requirement in the year 2011 to exceed the prior debt service requirement by $26,148.75. This amount has been yield restricted and placed in a special trust account with the trustee to be held until March 1, 2011. The deposit in effect, reduced the new debt service requirement not to exceed the prior debt service requirement.

NOTE 4. PAYABLE TO BORROWERS

This account represents interest earnings on restricted assets and loan principal overpayments that will be refunded to borrowers.

NOTE 5. DEBT PAYABLE

Notes. Revenue bond anticipation notes in the amount of $48,500,000 were issued in June 2003 to retire at maturity the $51,000,000 notes issued in 2002 and provide additional loan funds to local government units for water and sewer construction projects.

Notes payable at June 30, 2003, and June 30, 2002, are as follows (expressed in thousands):

	June 30, 2003	June 30, 2002
Revenue bond anticipation notes, 2.00%, issued June 9, 2003, maturing June 7, 2004 (includes unamortized premium of $450)	$ 48,950	$ –
Revenue bond anticipation notes, 1.66%, issued June 12, 2002, maturing June 11, 2003 (includes unamortized premium of $513)	–	51,513
Total notes payable	$ 48,950	$ 51,513

Short-term debt activity for the year ended June 30, 2003, net of unamortized premium (expressed in thousands):

Beginning Balance	Additions	Reductions	Ending Balance
$51,513	$48,950	$51,513	$48,950

Short-term debt activity for the year ended June 30, 2002, net of unamortized premium (expressed in thousands):

Beginning Balance	Additions	Reductions	Ending Balance
$42,025	$51,513	$45,025	$51,513

Revenue bonds. Bonds payable at June 30, 2003, and June 30, 2002, are as follows (expressed in thousands):

	June 30, 2003	June 30, 2002
Refunding revenue bonds, 4.0% to 7.25%, issued January 14, 1987, due in various amounts of principal and interest from $.12 million in 2004 to $.5 million in 2015 (net of unamortized discount of $333 at June 30, 2003, and $608 at June 30, 2002)	$ 2,238	$ 3,713
Refunding revenue bonds, 2.5% to 5.75%, issued July 7, 1993, due in various amounts of principal and interest from $.9 million in 2004 to $1.0 million in 2011	5,970	17,805
Refunding revenue bonds, 4.75% to 5.125%, issued November 1, 1997, due in various amounts of principal and interest from $3.3 million in 2004 to $.015 million in 2022 (net of unamortized discount of $57 and deferred amount on refunding of $1,395 at June 30, 2003, and unamortized discount of $61 and deferred amount of refunding of $1,473 at June 30, 2002)	27,493	29,146

Refunding revenue bonds, 1.95% to 4.00%, issued January 30, 2003, due in various amounts of principal and interest from \$1.3 million in 2004 to \$.16 million in 2015 (net of unamortized premium of \$56 and deferred amount on refunding of \$407 at June 30, 2003)	7,944	–
Net bonds payable	\$ 43,645	\$ 50,664

Debt service requirements to maturity of the revenue bonds payable at June 30, 2003, are as follows (expressed in thousands):

For the Year(s) Ending June 30	Principal	Interest	Total
2004	\$ 3,355	\$ 2,196	\$ 5,551
2005	3,560	2,026	5,586
2006	3,425	1,870	5,295
2007	3,145	1,725	4,870
2008	3,305	1,588	4,893
2009-2013	17,048	5,453	22,501
2014-2018	10,823	1,689	12,512
2019-2022	1,120	101	1,221
Total	\$ 45,781	\$ 16,648	\$ 62,429

The above principal for bonds does not reflect a \$1,802,000 deduction from bonds payable for the deferred amount on refunding.

Loan from the State of Tennessee. On June 2, 1999, the State Funding Board loaned \$16,000,000 to the Authority for the Community Provider program. The loan is to be repaid from amounts received from the borrowers. The interest rate on the loan varies according to market conditions for the State of Tennessee's general obligation commercial paper. The rate ranged from 1.26% to 1.87% during 2003, and from 1.83% to 3.76% during 2002. The Authority has repaid \$7,700,000 as of June 30, 2003, and \$3,700,000 as of June 30, 2002.

Changes in long-term debt payable for the year ended June 30, 2003, are as follows (expressed in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable				
Revenue bonds	$ 52,806	$ 8,295	$ 15,320	$ 45,781
Unamortized amounts				
Premium	–	58	2	56
Discount	(669)	–	(279)	(390)
Deferred amount on refundings	(1,473)	(419)	(90)	(1,802)
Total bonds payable	$ 50,664	$ 7,934	$ 14,953	$ 43,645
Loans	$ 12,300	$ –	$ 4,000	$ 8,300

Changes in long-term debt payable for the year ended June 30, 2002, are as follows (expressed in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable				
Revenue bonds	$ 56,831	$ –	$ 4,025	$ 52,806
Unamortized amounts				
Discount	(720)	–	(51)	(669)
Deferred amount on refundings	(1,552)	–	(79)	(1,473)
Total bonds payable	$ 54,559	$ –	$ 3,895	$ 50,664
Loans	$ 13,800	$ –	$ 1,500	$ 12,300

Refunding. On January 30, 2003, the Tennessee Local Development Authority issued $8.295 million in State Loan Programs Revenue Bonds, 2003 Series A, to refund $1.696 million of the outstanding 1986 bonds and $6.685 million of the outstanding 1993 bonds. Net proceeds of $8.353 million, which includes a net premium of $.058 million, combined with other funds available to the Authority, were used to purchase an escrow to redeem the 1986 bonds and 1993 bonds on March 1, 2003.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $.419 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2015 using the straight-line method. The Authority completed the refunding to reduce its total debt service payments over the next 12 years by $1.112 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $.455 million.

Prior Year Defeasance of Debt. Prior to fiscal year 2003, the Authority defeased certain revenue bonds of the Community Provider Program by placing the proceeds of general obligation notes in an irrevocable trust to provide for all future debt service payments on the defeased bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the financial statements of the Authority. On June 30, 2003, $8,305,000 of bonds outstanding were considered defeased. On June 30, 2002, $19,190,000 of bonds outstanding were considered defeased.

NOTE 6. PAYMENT TO PRIMARY GOVERNMENT

Pursuant to Section 41, Item 43 of the 2003 Appropriations Act, the Authority transferred $3,000,000 to the primary government to provide funds to the state's general fund for the fiscal year ended June 30, 2003.

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENTS OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003			June 30, 2002		
	State Loan Program	Community Providers	Total	State Loan Program	Community Providers	Total
ASSETS						
Current assets:						
Cash	$ 21,163	$ 1,576	$ 22,739	$ 26,942	$ 541	$ 27,483
Receivables:						
Loans receivable	3,355	637	3,992	4,225	831	5,056
Interest receivable on loans	9	10	19	4	16	20
Investments	452	-	452	299	-	299
Interest receivable on investments	220	-	220	182	-	182
Total current assets	25,199	2,223	27,422	31,652	1,388	33,040
Noncurrent assets:						
Restricted assets						
Investments	5,917	-	5,917	6,634	-	6,634
Loans receivable	72,712	7,350	80,062	78,460	11,529	89,989
Deferred charges	416	-	416	324	-	324
Total noncurrent assets	79,045	7,350	86,395	85,418	11,529	96,947
Total assets	104,244	9,573	113,817	117,070	12,917	129,987
LIABILITIES						
Current liabilities:						
Accrued interest payable	900	27	927	981	59	1,040
Payable to borrowers	402	14	416	601	18	619
Notes payable	48,950	-	48,950	51,513	-	51,513
Revenue bonds payable	3,355	-	3,355	4,225	-	4,225
Total current liabilities	53,607	41	53,648	57,320	77	57,397
Noncurrent liabilities:						
Loan from the State of Tennessee	-	8,300	8,300	-	12,300	12,300
Revenue bonds payable, net	40,290	-	40,290	46,439	-	46,439
Total noncurrent liabilities	40,290	8,300	48,590	46,439	12,300	58,739
Total liabilities	93,897	8,341	102,238	103,759	12,377	116,136
NET ASSETS						
Restricted	351	-	351	351	-	351
Unrestricted	9,996	1,232	11,228	12,960	540	13,500
Total net assets	$ 10,347	$ 1,232	$ 11,579	$ 13,311	$ 540	$ 13,851

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003			Year Ended June 30, 2002		
	State Loan Program	Community Providers	Total	State Loan Program	Community Providers	Total
OPERATING REVENUES						
Revenue from loans	$ 3,742	$ 884	$ 4,626	$ 4,349	$ 972	$ 5,321
Interest income	1,042	11	1,053	966	19	985
Net (decrease) in fair value of investments	(196)	-	(196)	(115)	-	(115)
Total operating revenues	4,588	895	5,483	5,200	991	6,191
OPERATING EXPENSES						
Interest expense	3,642	191	3,833	4,240	323	4,563
Subsidy to borrowers	442	11	453	639	16	655
Bond issuance cost	28	-	28	25	-	25
Arbitrage expense	162	-	162	-	-	-
Loss on extinguishment of debt	84	-	84	-	-	-
Administrative expense	219	1	220	139	1	140
Total operating expenses	4,577	203	4,780	5,043	340	5,383
Operating income	11	692	703	157	651	808
NONOPERATING REVENUE						
Payment from the State of Tennessee	25	-	25	-	-	-
Payment to the State of Tennessee	(3,000)	-	(3,000)	25	-	25
Total nonoperating revenue (expense)	(2,975)	-	(2,975)	25	-	25
Change in net assets	(2,964)	692	(2,272)	182	651	833
Net assets, July 1	13,311	540	13,851	13,129	(111)	13,018
Net assets, June 30	$ 10,347	$ 1,232	$ 11,579	$ 13,311	$ 540	$ 13,851

TENNESSEE LOCAL DEVELOPMENT AUTHORITY
SUPPLEMENTARY STATEMENTS OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEAR ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003			Year Ended June 30, 2002		
	State Loan Program	Community Providers	Total	State Loan Program	Community Providers	Total
CASH FLOWS FROM OPERATING ACTIVITIES						
Payments to federal government	$ (162)	$ -	$ (162)	$ -	$ -	$ -
Payments to service providers	(219)	(1)	(220)	(139)	(1)	(140)
Net cash used by operating activities	(381)	(1)	(382)	(139)	(1)	(140)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Proceeds from the sale of bonds	8,353	-	8,353	-	-	-
Proceeds from the sale of notes	48,978	-	48,978	51,541	-	51,541
Principal payments	(66,320)	(4,000)	(70,320)	(48,525)	(1,500)	(50,025)
Interest paid	(4,131)	(223)	(4,354)	(4,807)	(402)	(5,209)
Subsidy to borrowers	(526)	(18)	(544)	(781)	(110)	(891)
Payment from the State of Tennessee	25	-	25	-	-	-
Payment to the State of Tennessee	(3,000)	-	(3,000)	25	-	25
Net cash used by noncapital financing activities	(16,621)	(4,241)	(20,862)	(2,547)	(2,012)	(4,559)
CASH FLOWS FROM INVESTING ACTIVITIES						
Loans issued	(7,936)	-	(7,936)	(8,976)	-	(8,976)
Collections of loan principal	14,729	4,401	19,130	9,373	878	10,251
Interest received on loans	3,448	864	4,312	4,345	966	5,311
Purchases of investments	(5,333)	-	(5,333)	-	-	-
Proceeds from maturity of investments	5,725	-	5,725	-	-	-
Interest received on investments	980	12	992	966	19	985
Bond issuance costs paid	(203)	-	(203)	-	-	-
Premium paid	(187)	-	(187)	-	-	-
Net cash provided by investing activities	11,223	5,277	16,500	5,708	1,863	7,571
Net increase (decrease) in cash	(5,779)	1,035	(4,744)	3,022	(150)	2,872
Cash, July 1	26,942	541	27,483	23,920	691	24,611
Cash, June 30	$ 21,163	$ 1,576	$ 22,739	$ 26,942	$ 541	$ 27,483
Reconciliation of operating income to net cash used by operating activities:						
Operating income	$ 11	$ 692	$ 703	$ 157	$ 651	$ 808
Adjustments to reconcile operating income to net cash used by operating activities:						
Amortization	28	-	28	25	-	25
Revenue from loans	(3,742)	(884)	(4,626)	(4,349)	(972)	(5,321)
Investment income	(846)	(11)	(857)	(851)	(19)	(870)
Interest expense	3,642	191	3,833	4,240	323	4,563
Loss on extinguishment of debt	84	-	84	-	-	-
Subsidy to borrowers	442	11	453	639	16	655
Total adjustments	(392)	(693)	(1,085)	(296)	(652)	(948)
Net cash used by operating activities	$ (381)	$ (1)	$ (382)	$ (139)	$ (1)	$ (140)
Noncash investing activities:						
(Decrease) in fair value of investments	$ (196)	$ -	$ (196)	$ (115)	$ -	$ (115)